the structure of Canadian markets, compared to the operation of standard classical economic models.

Mr. Bouey also suggested that strong demand conditions, especially in Western Canada, were contributing to inflation. He noted Canada's world leading employment growth record over the past decade and continuing tight labour markets, especially for skilled workers.

Productivity

All three witnesses agreed that the weak productivity performance of the post-OPEC period may have also contributed to inflation. They pointed out that improved productivity growth could ease inflationary pressures in two ways; first it could directly reduce the actual costs of production, and second it could increase the available supply of goods and services thus reducing demand pressures. While the causes of the past weak productivity growth remain somewhat of a mystery to economists, Mr. Bouey did suggest that the energy price shocks of the past decade may have effectively rendered some portion of the capital stock obsolete for efficient production. Dr. Slater pointed out that while the economy has invested heavily over the past decade, much of the investment went into large scale projects with long term payoffs, and into environmental improvement efforts with little impact on measured rates of productivity. He emphasized that the economy still faces "an investment decade or unprecedented proportions" and thus it is imperative that Canadian savings rates not be diminished, and that government usage of savings should be curtailed.

Expectations

The witnesses were also unanimous in pointing to entrenched expectations as contributing to current levels of inflation. Mr. Bouey suggested that only through a prolonged period of lower inflation could these expectations be reduced. In his words, "It took 15 or 20 years to build them (expectations) up, and it is going to take a while to get them turned around." Dr. Stewart suggested that these expectations were now part of the structure of the economy, "there is no quick and easy remedy."

Energy Prices

Aside from their possible impacts on productivity, the energy price increases were suggested to have contributed directly to inflation. In particular, in late 1978 and early 1979, the international oil price soared 150%. This engendered inflationary pressures throughout the western world according to Dr. Stewart. In Canada, this has meant that the economy has had to absorb even larger and more rapid energy and import price increases.

Monetary Policy

Despite the Bank of Canada's avowed efforts to combat inflation, it may be that monetary policy is not itself entirely blameless for the current inflationary dilemma. The Governor of the Bank told the Committee that the decision to allow Canadian exchange rates to decline over the last 4-5 years vis-à-vis the U.S. dollar has contributed to inflation by way of demand pressures from export markets, and through increased prices of imported goods. The Governor admitted that last year's decision to allow Canadian interest rates to decline in line with U.S. rates may have been "a mistake". "The monetary policy probably should have been tougher right through last year". With regard to the policy of the Bank over the past few years, Mr. Bouey said that the Bank's targeted reductions in the money supply may have been "too gradual": "We have met our money supply targets every year, which is a bit of an embarrassment when you consider that things did not work out."

B. Policy Prescriptions

The witnesses showed remarkable unity in their suggestions of policies which might be deployed to reduce inflation. In particular, all three favoured a gradualist approach. Speaking for the Economic Council, Dr. Slater stated: "We believe that a balanced approach and a balanced policy, with monetary restraint and fiscal restraint and some other policies would be the appropriate way to go at it". Mr. Bouey suggested that fiscal and "a host of more specific policies affecting the way that individuals, businesses, trade unions and others operate in the market place" might be used in conjunction with an appropriate monetary policy to influence inflation. And Dr. Stewart, in more general terms suggested the need "to use every instrument of the traditional kind available to us—monetary policy, fiscal policy, et cetera" to "get out of this mess with the least cost in the real loss of income and jobs possible, consistent with the gradual elimination of inflation."

The Fiscal Attack

The budget of last October projected a budget deficit of some $10.3 billion dollars. The witnesses suggested that a reduced deficit might contribute to the fight against inflation. First, as excess demand in the economy appears to be creating inflationary price pressures, a reduced deficit would lower demand and thus ease inflationary pressures. Dr. Stewart for example, pointed to the boom conditions in Western Canada and in certain export sectors which translate into inflation in other sectors. Fiscal policies which reduce demand in these sectors, either through expenditure cuts or tax increases, might help. Our witnesses stressed that appropriately applied fiscal policies might be more equitable, and specific than monetary policies in the anti-inflationary battle, and this in itself may represent an important policy consideration.

With regard to federal spending, Dr. Stewart restated the government's policy that expenditure growth should be restrained to the rate of growth of G.N.P. or less. This policy, he noted, has resulted in a reduction of new program spending to roughly 1½% of the previous year's total expenditures. However, significant expenditure cuts, we were told, may be very difficult. According to Dr. Stewart, when increased public debt charges and energy costs are taken into consideration, "there may be virtually no room for net new programs." Mr.